ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Sher, et al	Analyst:	Jeani Brent	Bill Number:	SB 705
Related Bills:	See Legislative History	Telephone:	845-3410	Amended Date:	06/16/1999
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Research Expenses Credit/Increase Credit Percentage

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would increase the state credit for "qualified research expenses" from 11% to 12%.

SUMMARY OF AMENDMENT

The June 16, 1999, amendments removed the bills provisions that would have made Legislative declarations regarding the Budget Act and replaced them with the provisions discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would become effective upon enactment and specifies that its provisions would apply to taxable or income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 68 (1999) would have increased the qualified research expenses credit from 11% to 13% and would have increased the minimum threshold for the taxpayer's base amount from not less than 50% to not less than 35% of the taxpayer's current year qualified research expenditures. SB 465 (1999) would increase the alternative incremental research expenses credit to 100% of the federal amount.

SPECIFIC FINDINGS

Existing federal law provides for a research tax credit equal to 20% of the amount by which a taxpayer's qualified research expenditures for a taxable year exceed its base amount for that year.

Existing federal law also provides an additional basic research credit for universities and an alternate incremental research credit scheme, but these provisions will not be summarized since this bill does not concern those credits.

The federal research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. In computing the credit, a taxpayer's base amount may not be less than 50% of its current-year qualified research expenditures.

Board Position:			Department Director	Date
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____ N	____ OUA	X PENDING	**Gerald Goldberg**	**6/24/1999**

Qualified research expenditures eligible for the research tax credit consist of: (1) “in-house” expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; (3) 65% of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses"); and (4) 75% of amounts paid to a research consortium for qualified research if the research consortium is a tax-exempt organization and is organized and operated primarily to conduct scientific research, and the qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

To be eligible for the credit, the research must not only satisfy the existing research expenses deduction requirements, but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors. In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business component to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control.

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Existing state law conforms with specific modifications to the federal research credit, as follows:

- “Basic research” must be conducted in California to qualify for the California credit.
- Research that has a specific commercial objective may qualify as “basic research.”
- The credit percentage is 11% for "qualified research" and 24% for corporations for “basic research." To duplicate the federal provision that allows the credit for “basic research” payments only to corporate taxpayers, the B&CTL allows the credit based on “qualified research expenses” and “basic research” payments, while the PITL allows the credit only for “qualified research expenses."
- The state definition of “gross receipts” for purposes of the credit differs from that used in the federal credit.
- The termination dates provided under federal law do not apply to state law. The California research credit is permanent and is allowed for taxable and income years beginning on or after January 1, 1987.

This bill would increase the state credit for "qualified research expenses" from 11% to 12%.

Implementation Considerations

Implementing this bill would occur during the department's normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this bill is estimated to be revenue losses as shown below:

Revenue Impact of SB 705 Effective for income years Beginning on or After 1/1/99 Enacted after 6/30/99			
Losses in $ Millions			
1999/00	2000/01	2001/02	2002/03
-$5	-$7	-$8	-$9

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

The revenue impact of this proposal is estimated in the following manner. The research credits generated under current and proposed law are simulated for each corporation for the 1992 tax year based on a sample of 50 corporations with large research and development expenses. The simulation takes into account the taxpayers' income, historical research expenditures, and detailed tax and financial data. The results are weighted statistically to the population level. The revenue losses are estimated as the differences between the taxes under the current and proposed law. The revenue losses for 1992 are extrapolated to the 1999/00 and later fiscal years using projected growth rates of business profit provided by the Department of Finance.

BOARD POSITION

Pending.